

WHAT DOES BEING ON THE “WATCH LIST” MEAN?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.

WHY ARE FUNDS PLACED ON THE WATCH LIST?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

1. **Performance**—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
2. **Risk**—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
3. **Risk-Adjusted Returns**—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
4. **Portfolio Construction/Style Drift**—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
5. **Operations**—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely.

There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

Current Watch List Summary

The following funds are on the watch list as of 12/31/2007:

Ariel Fund: The funds' performance has improved greatly this year, but continues to lag for the longer-term periods. The fund ranks in the 33rd percentile for small - mid cap value funds over the one-year period that ended November 30, 2007. The fund has moved up in market cap; therefore, we have reclassified it as a Small-Mid Value Fund benchmarked to the Russell 2500 Value Index. For those participants who bought this fund for small value exposure, the Plan has added a new small value option, the Northern Small Cap Value Fund. We are keeping the fund on the watch list due to the longer-term returns, but are encouraged by what we have seen this year.

Legg Mason Value Trust continues to be hurt by exposure to home builders and to mortgage companies such as Countrywide. The fund had outperformed the S&P 500 Stock Index 15 straight calendar years, but it is in the 97th percentile for the one-year period ending November 30, 2007. This fund is highly concentrated and, therefore, volatile. For those wishing for a more stable large-cap blend option, there is the Vanguard Index Fund in the Plan.

Wells Fargo Advantage Large Company Growth Fund:

The fund has continued to underperform throughout this quarter. It seemed well positioned to take advantage of a market dominated by growth, with a high weighting in technology, and eventually the market will cycle in that direction. Still, we are concerned that the fund has not performed better. We will continue to monitor the situation.

T. Rowe Price International Stock: The fund remains on the watch list due to long-term mediocre performance. T. Rowe Price changed the manager in October 2007. We will continue to monitor this fund closely.

Insight



A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

NEW THIS QUARTER: CONCISE, ONE-PAGE ACCOUNT STATEMENT

The State of Illinois recognizes the importance of providing all employees with the best resources to plan for a well-deserved retirement. That's one reason we are taking steps to improve the look and feel of all communications relating to the Deferred Compensation Plan. As part of this effort, you may have noticed that—starting this quarter—your account statement has been consolidated into a concise, one-page summary format.

Our hope is that the new statement will provide a quick snapshot of your account with personalized information that can help you save time and better manage your savings.

The front of the summary statement features key account information, including:

- Balances
- Account value
- Asset allocation
- A summary of recent activity

The back contains more detailed information, including:

- Plan messages
- Investment activity

You can also customize your statement with additional details by calling T. Rowe Price at 1-888-457-5770, or visiting the myRetirementPlan Web site at rps.troweprice.com.

If you prefer the longer format, you can still view and print full statements (current and future) using the online statement service. Click on the Services tab to learn more.

HAPPY NEW YEAR: IMPORTANT REMINDERS

As you begin the new year, keep these important dates and contribution limits in mind.

- 2008 contribution limits
 - Pretax deferral limits for 457 plans \$15,500
 - Age 50 catch-up contribution limit \$5,000
 - Special catch-up limit \$31,000
(three years prior to normal retirement age—special rules apply)
- 1099-Rs will be mailed by January 31, 2008
- Age 70½ RMDs must be received by April 1, 2008

Please also note that in the coming months we will be rolling out additional communications that will highlight important features of the Deferred Compensation Plan and make it easier than ever for you to take advantage of the Plan.

REQUIRED MINIMUM DISTRIBUTIONS

If you turn age 70½ in 2008 and have left state service, you must receive your 2008 required minimum distribution (RMD) by April 1, 2009. To calculate your RMD, divide your account balance as of December 31, 2007, by 27.4 if you turn age 70 in 2008 or 26.5 if you turn age 71. This is the minimum amount that you must withdraw from your account.

Each year thereafter, you must receive your RMD by December 31. You can choose to receive payments automatically by completing Installments on the Participant Distribution Method Election form. Your minimum will be calculated and distributed for you each year if you choose the “payments over recalculated life expectancy” in the installment section of the form.

STABLE VALUE RETURN FOR 2008

Utilizing the current rate environment, historical participant cash flows, and INVESCO's modeling assumptions, the rate of return for the Stable Return Fund is estimated at a range of 4.55% - 5.05% for 2008. During the year, it is expected that reinvestment rates will remain flat or slightly decrease. As a result, the estimated blended return for the year will decrease from the previous year.

IMPORTANT TAX INFORMATION

Currently deferring participants

If you are actively contributing to the Plan, your taxable income was reduced thanks to your participation. You will only report the wages shown in Box 1 of your W-2 statement on your income tax form.

Box 1 wages have been reduced by the total amount of your 2007 deferrals and any other tax-deferred and tax-exempt deductions. Your W-2 statement will reflect contributions to the Deferred Compensation Plan (457). The amount of your deferral is indicated in Box 12 with a G coding. Remember, you do not enter your deferred compensation anywhere on your income tax form.

For participants on payout

If you received a payment from your account during the 2007 tax year, you will receive a separate 1099-R mailed by January 31, 2008, from our recordkeeper, T. Rowe Price. Box 2a of your 1099-R will list the taxable amount of the distribution(s) you received during 2007 and should be entered on line 16b of form 1040. Box 7 of your 1099-R is the distribution code for the type of distribution you received. A code of 7 in this box indicates a normal distribution for a participant over age 59½. If you were under age 59½, Box 7 will be coded with a 2 to indicate that your 457 Plan distributions are not subject to the 10% additional tax on early distributions. (As a general rule, 457 plans are not subject to a 10% penalty.)

For federal income tax purposes, your deferred compensation plus any earnings is taxable as retirement income when it is distributed. Deferred compensation distributions are not subject to the State of Illinois income tax. Report the distribution in the “federally taxed retirement and Social Security” subtraction section—line 5 of your Illinois return.

DON'T PANIC WHEN YOU SEE A BEAR

Bumping into a bear market—a period of falling share prices—can be almost as scary as stumbling across a real bear. But what's true in the woods is true in the markets. When you encounter a bear, don't make a sudden move.

Even before you contributed your first dollar to the State of Illinois Deferred Compensation Plan, you probably knew one important fact about the stock market: It goes up and down. But don't forget another fact. Over time the stock market has risen, going on to beat previous highs. However, past performance cannot guarantee future results.

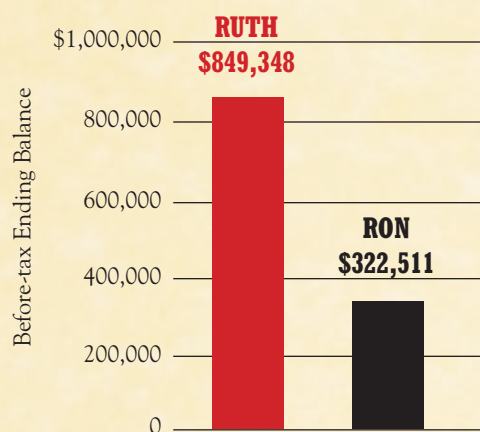
As a long-term investor for retirement, you need to keep the “long-term” perspective. When headlines are screaming “Markets Fall,” you may need to resist the urge to change your investments.

To be ready for the bulls, don't run from the bears

Many people say they've succeeded by “working hard and being in the right place at the right time.” For retirement investors, this means keeping your money ready for any potential market upturns (bull markets). Since no one can predict the ups and downs of the market, this simply means staying with your strategy (based on your risk tolerance and time frame).

Being ready for market gains may be as important as trying to avoid downturns. For example, Ruth invested all her savings in stocks. She stayed with her strategy regardless of how the markets rose or fell. Ron started with the same strategy, but moved his money out of the market when he thought stocks might go down. In fact, he missed the 10 best months for stock market performance. At the end of a 30-year period, Ruth's account was worth \$849,348, but Ron's was worth only \$322,511. That's a difference of almost \$527,000!

A patient, long-term approach can lead to bigger rewards



RUTH took the long-term approach. She had many years until she planned to retire and use her savings, so she put her money into stocks—and left it alone for 30 years.

RON used a market timing strategy. Since he kept moving his money into and out of the stock market, he ended up missing out on the 10 best-performing months for stocks during that 30-year period.

This example is based on an initial balance of \$25,000 and uses the performance of the S&P 500 Stock Index from 12/31/1976 to 12/31/2006. In Ron's case, a corresponding 30-day U.S. Treasury bill return was used for each of the 10 months the S&P 500 Stock Index was highest, and it was assumed that Ron's market timing strategy had him out of the market during those times.

This chart is for illustrative purposes only. This is not meant to represent the performance of the investment options in your Plan. Past performance cannot guarantee future results. It is not possible to invest directly in an index.

Unlike stocks, U.S. Treasury bills are guaranteed as to the timely payment of interest and principal. The S&P 500 tracks the stocks of 500 U.S. companies.

30-day U.S. Treasury bills track short-term U.S. government debt instruments.

Don't "sell low," then "buy high"

Some investors diligently follow news reports about market movements. Attempting to protect their assets, they move their money out of a fund when the market has already gone down. Then they put money back where it was once when the market has gone up again.

Unfortunately, what they're actually doing is "selling low" and "buying high." Let's say, for example, that the average price you have paid for Stock A over a three-year period is \$6 per share. When the value of Stock A drops to \$5, you panic and move your assets to a money market fund. You've sold low at a price per share lower than the average price you've paid. If Stock A then goes back up to \$7, you may decide to reinvest since it's doing well. Oops! Now you're paying more per share—buying high.

Bears can be your friends

Bear markets, though they can be scary, actually have a positive side. When you save through your employer's Plan, you're investing the same amount every month, which is called dollar cost averaging.* This means your money buys more shares when prices fall (and less shares when prices rise). Over time, you average out the cost of your mutual fund shares.

Call 1-888-457-5770 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

**Dollar cost averaging can't guarantee a profit or protect you from a loss.*

THE T. ROWE PRICE RETIREMENT FUNDS

T. Rowe Price Retirement Income Fund	TRRIX
T. Rowe Price Retirement 2005 Fund	TRRFX
T. Rowe Price Retirement 2010 Fund	TRRAX
T. Rowe Price Retirement 2015 Fund	TRRGX
T. Rowe Price Retirement 2020 Fund	TRRBX
T. Rowe Price Retirement 2025 Fund	TRRHX
T. Rowe Price Retirement 2030 Fund	TRRCX
T. Rowe Price Retirement 2035 Fund	TRRJX
T. Rowe Price Retirement 2040 Fund	TRRDY
T. Rowe Price Retirement 2045 Fund	TRRKX
T. Rowe Price Retirement 2050 Fund	TRRMX
T. Rowe Price Retirement 2055 Fund	TRRNX

STOCKS

Ariel Fund	ARGFX
Columbia Acorn Fund, Z	ACRNX
Fidelity Puritan Fund	FPURX
Legg Mason Value Trust	LMVFX
LSV Value Equity Fund	LSVEX
Northern Small Cap Value Fund	NOSGX
T. Rowe Price International Stock Fund	PRITX
Vanguard Institutional Index Fund	VIIIX
Wells Fargo Large Company Growth Fund	NVLCX

BONDS

T. Rowe Price New Income Fund	PRCIX
Vanguard Total Bond Market Index Fund, Institutional	VBTIX

MONEY MARKET/STABLE VALUE

Stable Return Fund	N/A
Vanguard Prime Money Market Reserves	VMRXX

TELEPHONE NUMBERS

Deferred Compensation

Plan Rules/Options Information

800-442-1300/ 217-782-7006

TDD/TTY: 800-526-0844

Internet: <http://www.state.il.us/cms/employee/defcom>

Recordkeeper

T. Rowe Price Retirement Plan Services, Inc.

Account Value Information and Investment Changes:

888-457-5770 or TDD/TTY: 800-521-0325

Internet Access: 800-541-3022

Internet: <http://rps.troweprice.com>